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FISCAL IMPACT STATEMENT

LS 6026 **NOTE PREPARED:** Jan 1, 2015
BILL NUMBER: SB 286 **BILL AMENDED:**

SUBJECT: Taxation of Civil Service Annuities.

FIRST AUTHOR: Sen. Tomes **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X **GENERAL** **IMPACT:** State & Local
DEDICATED
FEDERAL

Summary of Legislation: The bill provides that the maximum state income tax deduction for federal civil service annuity income is equal to the lesser of: (1) the amount of federal civil service annuity income received during the taxable year; or (2) the average annual federal Social Security retirement benefit paid to Indiana retired workers during the calendar year preceding the taxpayer's taxable year. The bill provides that the deduction is also available to a surviving spouse. The bill retains the provision that reduces the deduction by the amount of any federal Social Security and railroad retirement benefits received by the taxpayer during the taxable year.

Effective Date: January 1, 2015 (retroactive).

Explanation of State Expenditures: *Department of State Revenue (DOR):* The DOR will incur additional expenses to revise tax forms, instructions, and computer programs to reflect the changes in this deduction. The DOR's current level of resources should be sufficient to implement this change.

Explanation of State Revenues: *Summary-* This bill increases the allowable deduction for federal civil service annuity pay from $2,000 to the lesser of the actual civil service annuity received or the mean Social Security retirement benefit paid to Indiana retired workers in the prior taxable year. Unchanged by the bill, the deduction is reduced by the amount of any federal Social Security and railroad retirement benefits received by the taxpayer during the taxable year. In addition, the bill allows surviving spouses to claim the deduction.

Since the bill goes into effect in tax year 2015, the revenue loss would likely begin in FY 2016. The estimated revenue loss from changing the deduction could be about $4.3 M in FY 2016 and $4.4 M in FY

2017. The revenue loss could remain relatively flat or grow by as much as 3.0% annually thereafter due to growth in the federal retiree population and the cost-of-living adjustments (COLA) to Social Security retirement benefits.

Additional Information - In 2012, 4,548 taxpayers deducted approximately $8.1 M in civil service annuity pay from their adjusted gross income (AGI). This resulted in a revenue loss of about $270,000.

Data from the U.S. Office of Personnel Management indicates that there were about 20,165 Civil Services Retirement System (CSRS) retirees and about 6,774 surviving spouses of CSRS retirees residing in Indiana. The federal CSRS retirees received an estimated $750.5 M in annuity payments and surviving spouses of CSRS retirees received an estimated $118.7 M in annuity payments during 2014. The average payment to a federal CSRS retiree was about $37,000, and the average for surviving spouses was about $17,500. The total payments to retirees and their spouses in Indiana increased, on average, 3.75% annually over the past four years.

According to the Office of Retirement and Disability Policy of the U.S. Social Security Administration (OASDI), the average annual Social Security retirement benefit paid to Indiana retired workers was $16,270 in 2013. Since the deduction goes into effect for tax year 2015, the average retirement benefit was adjusted for CY 2014 and CY 2015 using the COLA published on the OASDI website. The estimated average Social Security benefit used was $16,515 for CY 2014 and $16,796 for CY 2015.

The estimate relating to civil service annuitants assumes those currently claiming the $2,000 deduction (4,548 taxpayers) will be able to claim the additional deduction amounts. It also assumes that about 9,400 additional civil service annuitants will be able to claim part or all of the additional deduction. The estimate relating to surviving spouses assumes that survivor's benefits and Social Security payments to these individuals are distributed similar to civil service annuitants.

Explanation of Local Expenditures:

Explanation of Local Revenues: The change to this deduction will decrease taxable income, so counties imposing local option income taxes (LOIT) could potentially experience a decrease in revenue. Using the median current LOIT rate of 1.45%, LOIT collections on a statewide basis could potentially be reduced by an estimated $1.9 M in FY 2016 and FY 2017.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties with local option income taxes.

Information Sources: LSA Income Tax Databases,1996-2012; Social Security Benefits, Beneficiary Data, http://www.ssa.gov/OACT/ProgData/types.html; OASDI, *OASDI Beneficiaries by* Sate and County: Indiana, http://www.ssa.gov/policy/docs/statcomps/oasdi_sc/index.html ; Data on Federal Civil Service Annuitants in Indiana, U.S. Office of Personnel Management (OPM); FEDSCOPE: OPM Personnel Reporting Cube, http://www.fedscope.opm.gov/.

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